

Summary:

Reno, Nevada; General Obligation

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Reno GO

Long Term Rating

A+/Stable

Upgraded

Rationale

S&P Global Ratings raised its rating and underlying rating to 'A+' from 'A-' on Reno, Nev.'s outstanding limited-tax general obligation (GO) bonds. The outlook is stable.

The rating action reflects our view of the city's maintenance of structural balance and continued replenishment of the city's available fund balances; to a lesser extent, the rating actions also reflect our view of the city's improved management policies and practices.

A limited pledge of ad valorem taxes secures the bonds, subject to statutory limits on an overlapping tax rate of \$3.64 per \$100 of assessed value (AV), plus a two-cent state exemption. Reno is currently at the overlapping tax limit of \$3.66 per \$100 of AV. The series 2013A bonds are additionally secured by certain taxes imposed on the rental of transient lodging within Washoe County and 15% of the annual consolidated tax (C-Tax) revenues received by the city. The rating on the series 2013A bonds is based on the strength of the limited-tax pledge alone; we do not feel we have sufficient information to rate the additional pledged revenues. The series 2013B bonds are medium-term limited-tax bonds and are not secured by additional revenue. We rate the limited-tax GO debt on par with our view of the city's general creditworthiness.

The ratings further reflect our view of the following factors:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2017, which closed with slight operating surpluses in the general fund and at the total governmental fund level;
- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 12.3% of operating expenditures;
- Very strong liquidity, with total government available cash at 79.1% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 14.1% of expenditures and net direct debt that is 164.1% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Strong economy

We consider Reno's economy strong. The city, with an estimated population of 237,893, is located in Washoe County in the Reno, Nev., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 104.3% of the national level and per capita market value of \$83,044. Overall, the city's market value grew by 8.0% over the past year to \$19.8 billion in 2017. The county unemployment rate was 5.0% in 2016.

Reno, the county seat for Washoe County, serves as a convention and tourist destination, attracting auto visitors from Northern California and air travelers primarily from the western U.S. The local economy is slowly diversifying into health care and other industries, but aside from governmental employers, the leading industries continue to include leisure and hospitality, tourism, and casino gaming. In recent years, Tesla and Apple have opened significant industrial operations in Reno and the surrounding area--adding jobs and helping boost the city's tax base.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Our improved view of the city's management stems from our assessment of the city's revised debt management and capital improvement policies, as well as our view that the city has successfully emerged from its structural imbalance following the recession.

Highlights of the city's management practices include:

- A budget formation process that incorporates historical revenue and expenditure trends, as well as some independent revenue forecasts, though actual revenue has historically varied from projections;
- An annual budget process with formal revision at least once a calendar year, coupled with monthly monitoring of budget-to-actual results;
- A long-term financial plan that covers four years beyond the budgeted year;
- A 10-year capital improvement plan, updated annually as part of the budget process, that identifies all known revenue sources to support potential projects;
- A formal investment policy that details permitted instruments and portfolio objectives with monthly presentations to the board;
- A robust debt policy that includes qualitative and quantitative benchmarks, as well as annual monitoring of compliance; and
- A reserve and fund balance policy of maintaining 10% of general fund expenditures.

Weak budgetary performance

Reno's budgetary performance is weak in our opinion. The city had slight operating surpluses of 0.8% of expenditures in the general fund and of 1.2% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate from 2017 results in the near term.

The two major sources of revenue for Reno's general fund are the property tax and the C-tax. The city received

roughly the same amount from each source, and two revenue streams together represent approximately 57% of the city's total general fund revenues.

The city has finished the last two audited years with general fund surpluses: in 2016, a \$7.7 million surplus, or 4.6% of operating expenditures, and in 2017, a \$1.4 million surplus, or 0.8% of operating expenditures. According to management, the surpluses are being driven by strong growth in general fund revenues as well as by lower-than-budgeted expenditures due to unfilled vacancies. In 2018, the city budgeted for a \$2.9 million deficit (or 1.6% of operating expenditures), but according to management, the city should end the year with balanced results.

Our analysis reflects our assessment that expected increases in pension contributions could lead to deterioration in budgetary performance.

Property values have continued their recovery, but proportionate revenue recovery is limited. Property tax increases in Nevada on a per-parcel basis are capped at 3% annually for primary residential properties with exceptions for improved property value. For all other properties, annual property tax increases are limited to no more than 8% adjusted by the greater of average AV growth in the county or twice the Consumer Price Index (CPI). These caps do not limit the tax rate, but only the year-to-year increases in the property tax levy amount per parcel. Total AV is 35% of the appraised value; the Washoe County assessor appraises annually. In addition to the levy limits, a local government cannot receive an increase in property tax revenue more than 6% over the maximum revenue allowed for the prior year (excluding new construction). So, while the upside property tax revenue growth is limited, property tax revenue declines tend to be more correlated with declines in market value of real property.

The C-tax sales tax revenue is collected statewide and returned to local governments by a formula that factors in population and tax base growth. C-Tax revenues have steadily rebounded after steep declines during the recession (2008 through 2010), during which time they dropped by roughly 28.8%. Since then, the pace of revenue growth has accelerated: In 2011, revenues grew by 1.2%; in 2015, they rose by 10.9%. C-tax revenue continued to grow in 2016 (by 9.1%) and 2017 (by 2.4%), but at a slower pace.

As a result, the rating also incorporates our view of the city's vulnerability to fluctuating revenue due to its reliance on revenues with elevated cyclical volatility and down-side risk.

Strong budgetary flexibility

Reno's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 12.3% of operating expenditures, or \$21.6 million.

The city's recent general fund surpluses have led to increases in available fund balances in recent years--leading to an improvement in our assessment of the city's budgetary flexibility.

In 2014, the city set aside \$2.1 million to create a separate stabilization fund, a committed balance in a special revenue fund. The city's long-term goal is to fund the reserve at 10% general fund expenditures. Expenditures from this fund can only be used if total actual general fund revenue falls short of what is anticipated, or to pay for costs associated with a natural disaster. In 2017, the city drew on the reserve to pay for some costs associated with flooding; as a result, the stabilization fund ended the year with \$1.8 million. The city expects the stabilization fund to end 2018 with a

balance of \$2.4 million.

Based on budget projections for fiscal 2018, we expect the ending available general fund balance to remain at least strong.

Very strong liquidity

In our opinion, Reno's liquidity is very strong, with total government available cash at 79.1% of total governmental fund expenditures and 5.6x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We believe the city's investment policy restricts its ability to maintain an aggressive investment portfolio, and we have not identified any contingent risks that would jeopardize the city's liquidity. The city invests in the state-managed investment fund, federal and agency securities, and corporate notes. We do not expect the city's liquidity position to deteriorate over the medium term, based on historical performance and a lack of identified material risks to liquidity.

We note that the city has outstanding variable-rate bonds: series 2005A and series 2008A. These bonds are not secured by the city's general obligation pledge. The city has entered into interest rate swap transactions to hedge against the interest rate risk associated with this debt. As of June 30, 2017, the negative fair value of these swaps amounted to \$91.2 million. The city also has two letters of credit (LOCs) with Bank of America N.A. to ensure payment on each of these bonds. For more on the series 2005A, please see our report published Dec. 21, 2017, on RatingsDirect. We do not view these obligations as posing a material liquidity risk.

The city also has an outstanding privately placed taxable lease revenue bond (LRB) issued in 2014 with an original par of \$9.2 million and a final maturity of June 1, 2021; as of June 30, 2017, \$7.1 million remained outstanding. The series 2014 taxable LRBs contain acceleration language, and while the outstanding amount of the bonds is not significantly high, the city's LOC agreement with Bank of America associated with the city's 2005A variable-rate bonds includes a "most favored nations" clause that acceleration of any parity debt could trigger acceleration of the reimbursement agreement. The LOC would allow the trustee for the series 2005A bonds to draw up to an amount equal to the principal amount of the outstanding bonds, which totaled \$62.6 million as of June 30, 2017, plus interest.

However, should the acceleration language with the series 2014 taxable lease revenue refunding bonds be triggered, causing an acceleration, it would be only of the pledged revenues, which are lease revenues from the property. An acceleration of the 2014 LRBs would not trigger the "most favored nations" clause in the LOC reimbursement agreement the city has with Bank of America N.A. because the pledged revenues securing the bonds are different and are not on parity. As a result, we do not view these transactions as posing a material liquidity risk.

Very weak debt and contingent liability profile

In our view, Reno's debt and contingent liability profile is very weak. Total governmental fund debt service is 14.1% of total governmental fund expenditures, and net direct debt is 164.1% of total governmental fund revenue.

According to management, the city does not have any authorized but unissued debt and does not anticipate issuing additional long-term bonds in the medium term.

In our opinion, a credit weakness is Reno's large pension and OPEB obligation, without a plan in place that we think

will sufficiently address the obligation. Reno's combined required pension and actual OPEB contributions totaled 16.1% of total governmental fund expenditures in 2017. Of that amount, 13.2% represented required contributions to pension obligations, and 2.9% represented OPEB payments. The city made 100% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 72.2%.

The city contributes to the Public Employees Retirement System of the State of Nevada (PERS), a cost-sharing, multiemployer, noncontributory, defined benefit public employee retirement plan administered by Nevada PERS to provide retirement benefits, death benefits, and disability benefits. Using updated reporting standards in accordance with Governmental Accounting Standards Board (GASB) Statement Nos. 67 and 68, the city's net pension liability for Nevada PERS in the June 30, 2017, comprehensive annual financial report (measured as of June 30, 2016) was \$238 million.

The city also participates in an agent multiple-employer pension plan called the Judicial Retirement System (JRS) of Nevada for the city's municipal court judges and justices of the peace. As of the same date, the city had a net pension liability in JRS of \$378,000.

In our view, Nevada PERS' primary assumptions in setting liabilities and contribution rates have historically been on the aggressive side. As of the city's 2017 comprehensive annual financial report, Nevada PERS' utilized a discount rate of 8.0%, which is much higher than the national average of 7.5% (and trending downward) and is dependent on a general inflation assumption of 3.5% that the CPI has not met for many years. Additionally, the city's payroll growth assumption of 5% allows a significant deferral of contributions to later in the amortization schedule when payroll is expected to be much higher; however, actual growth rates have not been near 5% in the last decade. Finally, the city's mortality assumptions used to project life expectancies are based on a scale created in the year 2000, but actual mortality rates have improved significantly since then and are projected to continue to do so going forward.

In the summer of 2017, the Nevada PERS actuary presented the results of an experience study, and the board unanimously adopted all the recommendations, which included lowering the discount rate to 7.5%, lowering the annual inflation assumption to 2.75%, reducing the wage growth assumption by roughly the same amount as inflation, and adopting new mortality tables.

We view these changes as a more accurate reflection of the city's pension liability and a long-term positive; however, we believe the changes to the plan's actuarial methods and assumptions will cause a significant increase in the city's unfunded liabilities and future contribution rates. These changes took effect in the July 30, 2017, valuation. The city's net pension liability will reflect these changes starting in its June 30, 2018, audit. However, because Nevada PERS rates are only set every two years, the city's contribution rates won't be affected until 2019. According to management, Nevada PERS does not provide multiyear projections of contribution rates, so it's difficult for the city to accurately reflect the increases in its long-term financial plan.

Strong institutional framework

The institutional framework score for Nevada municipalities is strong.

Outlook

The stable outlook reflects our expectation that AV and retail sales will continue to grow, supporting continuation of the city's budgetary performance as well as the city's ongoing efforts to recover from the lingering effects of the recent recession. We don't expect to change our ratings during the two-year outlook horizon.

Downside scenario

We could lower the ratings if the city's labor costs are pressured and expenditures move out of alignment with ongoing revenue, particularly if AV growth slows--leading to a structural imbalance.

Upside scenario

We could raise the ratings if regional economic indicators continue to improve and the city continues to show positive performance and maintains available fund balance levels that we consider strong.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Nov. 1, 2017
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of March 20, 2018)		
Reno GO		
Long Term Rating	A+/Stable	Upgraded
Reno GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Reno GO		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

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